

ST 07-12

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS 60601**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JIM DOE & JANE DOE,
as responsible officers of ABC Enterprises, Inc.,**

Taxpayer

**No. 00-ST-0000
NPL No. 0000-000-00-0 (Doe)
NPL No. 0000-000-00-0 (Doe)
IBT: 0000-0000**

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Jim Doe and Ms. Jane Doe, appearing *pro se*; Mr. Marc Muchin, Special Assistant Attorney General, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to Jim Doe's and Jane Doe's protest of Notice of Penalty Liability No. 0000-000-00-0 (Jim Doe) and 0000-000-00-0 (Doe) as responsible officers of ABC Enterprises, Inc. (hereinafter ABC). The Notices of Penalty Liability (hereinafter NPL's) represent a penalty liability for retailers' occupation tax of ABC due to the Illinois Department of Revenue for December, 2003, June through December, 2004 and January and June, 2005. An evidentiary hearing was held in this matter on February 8, 2007, by telephone at the request of Mr. Doe and Ms. Doe, with both testifying. Following submission of all evidence and a review of the

record, it is recommended that both NPL's be finalized as issued. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. 0000-000-00-0 issued to Jim Doe and NPL No. 0000-000-00-0 issued to Jane Doe, both issued on October 20, 2005. The NPL's show a penalty for unpaid retailers' occupation tax liability of ABC Enterprises, Inc. in the amount of \$6,614.28 for the months of December, 2003, June through December, 2004 and January and June, 2005. Tr. pp. 4-6; Dept. Ex. Nos. 1 and 2.
2. ABC Enterprises, Inc. owned and operated franchised "XYZ Centers" and did business in six states, including Illinois. Tr. pp. 16, 17-18.
3. Mr. Doe was hired by ABC in August, 2003, as Chief Financial Officer. Mr. Doe was responsible for ABC's general ledger, financial statements and financial reporting. Mr. Doe invested \$50,000 in ABC and had check signing authority. Tr. pp. 9-10, 15, 17, 33.
4. During the period covered by the NPL's, Mr. Doe authorized payment for withholding taxes, insurance, employee wages and other expenses. Mr. Doe discussed these payments with ABC's President and suggested that sales taxes needed to be paid. Tr. p. 27.
5. Ms. Doe was hired by ABC in January, 2003, for a bookkeeping position and she set up sales tax accounts in Illinois and other states. Ms. Doe assembled the data for state sales tax reporting, prepared sales tax forms and tax returns and submitted them to Mr. Doe for review and authorization for payment. Ms. Doe reported to Mr. Doe and she had check signing authority. Ms. Doe invested \$25,000 in ABC. "Jane Doe" is listed as "Taxpayer Name" on ST-1 Returns for September, 2004, October, 2004, November, 2004, December, 2004, January,

2005 and June, 2005, months covered by the NPL. Tr. pp. 18-19, 22-24, 30-31, 33, 40, 43-44, 48; Dept. Ex. No. 3.

Conclusions of Law:

The issue to be decided in this case is whether Mr. Doe and Ms. Doe should be held personally liable for the unpaid retailers' occupation tax of ABC. 35 ILCS 120 *et seq.* The statutory basis upon which any personal liability is premised is Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section.
35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) "willfully" fails to file returns or make payments.

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S.

821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that Mr. Doe and Ms. Doe were responsible parties under the statute. Mr. Doe was hired by ABC in August, 2003. Mr. Doe described his position as “Chief Financial Officer” and “Senior Accounting Official.” Tr. pp. 8-9. Mr. Doe was responsible for ABC’s general ledger, financial statements and financial reporting. Tr. pp. 9-10, 17, 33. Mr. Doe testified that he “was responsible for determining debt payment and attempted to do so.” “Payments were made generally how I wanted them to be paid based on the funds that we had available.” Tr. p. 10. By Mr. Doe’s own admission, he had significant control over the business affairs of ABC. Monday, *supra*.

Mr. Doe testified that he had “personally invested funds into the corporation.” Tr. p. 8. Although he testified that he had invested \$50,000 in ABC, he did not know “his status as a shareholder.” He was issued shares of stock representing 20% ownership in ABC, but according to Mr. Doe, he did not provide information to XYZ “Corporate” that was required for him to become an authorized owner. Tr. pp. 14-15. No documentary evidence was offered by Mr. Doe to show why he was not an “authorized owner” of ABC. Mr. ABC has a degree in Accounting, but he is not “currently” a CPA. Tr. pp. 16-17. Mr. Doe’s lack of knowledge as to his shareholder status is disingenuous. Based on Mr. Doe’s admission that he invested \$50,000 in ABC for 20% ownership, I must conclude that Mr. Doe was a shareholder of ABC.

Mr. Doe testified that he resigned from ABC in January, 2005, with a written resignation. No documentary evidence was admitted to support this but Mr. Doe testified that he was “looking for a copy [of the resignation] now.” Tr. p. 16. Mr. Doe did not offer into evidence his written resignation. No corporate documents or annual reports were admitted as evidence to show

resignations, officers, changes in officers, or minutes of corporate meetings. Approximately 95% of the sales tax liability included in the NPL was incurred by ABC prior to Mr. Doe's undocumented resignation.

Ms. Doe was hired by ABC in January, 2003, for a bookkeeping position. Tr. p. 43. In July, 2003, Ms. Doe was "assigned" the position of "secretary" and she "guessed" that she became a corporate officer at that time. Tr. p. 51. Ms. Doe reported to Mr. Doe. Ms. Doe testified that she set up sales tax accounts in Illinois and other states. Ms. Doe assembled the data for state sales tax reporting, prepared sales tax forms and tax returns and submitted them to Mr. Doe for review and authorization for payment. "Jane Doe" is listed as "Taxpayer Name" on ST-1 Returns for September, 2004, October, 2004, November, 2004, December, 2004, January, 2005 and June, 2005, months covered by the NPL's. Dept. Ex. No. 3. Ms. Doe invested \$25,000 in ABC and testified that she was a shareholder in ABC. Ms. Doe testified that she resigned in January, 2005, by tendering a written letter of resignation. Tr. pp. 18-19, 22-24, 30-31, 33, 40, 43-44, 46-47, 48. Ms. Doe did not offer her written resignation into evidence. No corporate documents or annual reports were admitted as evidence to show resignations, officers, changes in officers, or minutes of corporate meetings. Approximately 95% of the sales tax liability included in the NPL was incurred by ABC prior to Ms. Doe's undocumented resignation.

Mr. Doe and Ms. Doe both testified that they had check signing authority. Mr. Doe testified that he and Ms. Doe had check signing authority at various banks for ABC during the audit period. Tr. p. 33. Ms. Doe testified that she drafted checks and was a signatory on the checking accounts for the business. Tr. p. 48. There was no testimony that more than one signature was required for checks and fund transfers. No bank signature authorizations were offered into evidence.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473 (E.D.N.Y. 1981), aff'd, 671 F. 2d 492 (2d Cir. 1982). Each time that Mr. Doe and Ms. Doe signed a check, they participated in “decisions regarding the payment of creditors and the disbursal of funds,” evidencing their status as responsible parties. Monday, supra. Because they both had check signing authority, either Mr. Doe or Ms. Doe could have unilaterally written a check to cover the Illinois taxes.

The admission into evidence of the NPL’s establishes the Department’s *prima facie* case with regard to both the fact that Mr. Doe and Ms. Doe were “responsible” officers and the fact that they “willfully” failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department established its *prima facie* case, the burden shifted to Mr. Doe and Ms. Doe to overcome the presumption of liability through sufficient evidence that they were either not responsible officers or employees, or that their actions were not willful. *Id.*

In order to overcome the Department’s *prima facie* case, taxpayers must present evidence which is consistent, probable and identified with the corporation’s books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). No documentary evidence was offered into evidence by either Mr. Doe or Ms. Doe. Without any documentary evidence to support their contentions, Mr. Doe and Ms. Doe have failed to rebut the Department’s presumption that they were responsible parties under the statute. Their testimony alone is not sufficient to rebut the Department’s *prima facie* case. Based on the lack of documentary evidence supporting their contentions, and their testimony as to their responsibilities and check signing authority, I conclude that Mr. Doe and Ms. Doe have failed to overcome the Department’s *prima facie* case that they were responsible parties of ABC.

The second element which must be met in order to impose personal liability is the willful failure to pay the taxes due. 35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay or file taxes. Branson v. Department of Revenue, 168 Ill. 2d 247 (1977). In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have adopted a broad interpretation of the words “willfully fails.” Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Under this broad interpretation, responsible officers are liable if they fail to inspect corporate records or otherwise fail to keep informed of the status of the tax returns and payments. Branson supra at 267. Willfulness also includes “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.” Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). “Willfulness” as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970).

Mr. Doe testified that he had conversations with the President of ABC and with Jane Doe “virtually every day.” Tr. pp. 34-35. Mr. Doe testified that he had “more than one conversation” with the President of ABC “regarding the importance of sales tax and the importance of allocating our funds differently than we were.” Tr. p. 8. According to Mr. Doe, the President’s highest priority for cash expenditures was the purchase of products of the company:

- Q. Would he put other payments aside so that he could purchase product?
- A. Yes, he would.
- Q. Did he ever put aside money that should have been paid for sales tax to purchase product?
- A. Absolutely, yes.
- Q. Did you ever tell him that those payments should be used for something other than product?
- A. Yes.
- Tr. pp. 37-38.

In his closing statement, Mr. Doe argued that ABC's President used the funds of the corporation as if they were his own personal funds. "I had a number of meetings with him, specifically regarding that, and felt like I had virtually no influence over that, irregardless of my title or as owner of the corporation, or intended owner of the corporation." Tr. p. 59.

Ms. Doe testified that there were several times, even weekly, when she would go over refunds that needed to be issued to customers as well as other payments that she was aware of, including sales tax, and ask "what are we going to pay this week." Ms. Doe would be told, by either Mr. Doe or ABC's President, that the company didn't have money to pay "for any of the things that you're working on, including sales tax." Tr. p. 45. Ms. Doe recalled specific instances where ABC's President withdrew funds from the company without authorization from Ms. Doe or Mr. Doe. There were several verbal discussions with ABC's President to "curb that activity." Tr. p. 57.

It is clear from Mr. Doe's and Ms. Doe's testimony that during the period covered by the NPL, they were aware that sales tax was not being remitted to the State and that ABC was having trouble paying its debts. There was no testimony or documentary evidence showing any positive steps that Mr. Doe or Ms. Doe took to pay the taxes to the State of Illinois. There was no testimony by either Mr. Doe or Ms. Doe that they ever inspected the corporate books, which as shareholders and corporate officers, they had the right to do. As discussed previously, either Mr. Doe or Ms. Doe could have written a check to the State for unpaid taxes.

At every meeting where the disbursal and misappropriation of funds was discussed by Mr. Doe and Ms. Doe with ABC's President, and at every meeting that there was a discussion about the priority of bills and payables, Mr. Doe and Ms. Doe disregarded the obvious risk that Illinois taxes were not being paid. There was no testimony that they tried in any way to correct what was clearly

mismanagement of ABC. Because Mr. Doe and Ms. Doe were aware that ABC was mismanaged, I must conclude again that they disregarded the obvious risk that Illinois taxes were not being paid. Reckless disregard for obvious or known risks will suffice to find willfulness under the statute. Branson, *supra*. Mr. Doe and Ms. Doe also disregarded the obvious risk that Illinois taxes were not being paid when they waited for, but never received a return from their own investment in the corporation. Tr. pp. 40, 60. If a responsible person does nothing, despite being in a position to easily discover nonpayment and clearly on notice of a grave risk of nonpayment, a finding of willfulness is justified. Branson, *supra*. Based on the testimony of Mr. Doe and Ms. Doe, and after considering the fact that no documentary evidence was offered by either party to rebut the Department's *prima facie* case of willfulness, I conclude that Mr. Doe and Ms. Doe have failed to rebut the Department's presumption that they willfully failed to pay the Illinois sales taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000-000-00-0 issued to Jim Doe and Notice of Penalty Liability No. 0000-000-00-0 issued to Jane Doe be finalized as issued.

Kenneth J. Galvin
Administrative Law Judge

May 16, 2007